United States Court of Appeals

for the Second Circuit

BRIEF FOR APPELLEE

76-5029

FINAL COPY

United States Court of Appeals

FOR THE SECOND CIRCUIT

In the Matter

of

INTERSTATE STORES, INC. formerly known as
INTERSTATE DEPARTMENT STORES, INC., et al.,

Debtor-Appellees.

DOMINICK'S FINER FOODS, INC.,

Appellant,

and

JOHN E. HANCOCK and AMF INCORPORATED,

Appellees.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

BRIEF OF APPELLEE AMF INCORPORATED

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QUESTION PRESENTED

Did the Court below properly reverse an order of the Bankruptcy Court confirming a sale when notice of the sale did not conform to the requirements of the Bankruptcy Rules and it was apparent that a reopened sale would be of substantial benefit to the creditors?

STATEMENT OF THE CASE

This is an appeal from an order of the U. S. District Court for the Southern District of New York dated July 19, 1976, (Cannella, J.) which vacated an order of the Bankruptcy Court dated May 24, 1976 (Ryan, B. J.). The Bankruptcy Court had confirmed a sale of certain property located in Chicago, Illinois (the "property") by the Trustees for the debtor herein (in Chapter X reorganization proceedings) to Dominick's Finer Foods, Inc. (hereinafter "Dominick's"), appellant herein. Appellees in this Court are the Trustees and the two appellants before the District Court, AMF Incorporated, (hereinafter "AMF") a creditor, and John Hancock, the frustrated purchaser at the sale which was reopened by the order appealed from.

The issues herein arise entirely from events occurring subsequent to the application of the Trustees, dated April 29, 1976, for an order approving their agreement with

Hancock, dated April 20, 1976, to sell him the Chicago Heights property.

For a description of these proceedings, we respectfully refer the Court to Judge Cannella's description of "The Facts" in his decision (A. 8a-12a), and add thereto only to bring them up to date.

On August 12, 1976, Dominick's filed its notice of this appeal. On August 13, 1976, application was made to Judge Cannella by Dominick's for a stay pending the decision of the instant appeal. The stay was denied, and no application was made to this Court for a stay. In the absence of a stay, and pursuant to the order of remand from Judge Cannella and an order of Bankruptcy Judge Ryan (A. 581a), notice was given on August 17, 1976, of a hearing to be held on September 10, 1976 for the purpose of confirming the sale of the property to Hancock for $725,000, or, in the alternative, to sell the property to any higher bidder (A. 583a). At the hearing, spirited bidding took place between Dominick's and Patrick J. Doyle. Dominick's stopped at $1,200,000, and the property was "knocked down" to Doyle for $1,210,000. (S.A. 627a-8a)*/ .

The sale to Doyle was confirmed by order of the Bankkruptcy Court dated September 14, 1976 (S.A. 589a). A notice of appeal of that order was filed in the District Court by Dominick's on September 24, 1976, but the appeal

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*/ Record references preceded by "S.A." refer to the Supplemental Joint Appendix

was abandoned. No stay of the sale was sought by Dominick's from either the Bankruptcy Court or the District Court. In the absence of a stay the sale to Doyle was consummated and Doyle entered into possession of the premises. (Aff. of Lewis Kruger sworn to Oct. 14, 1976 in support of motion to dismiss the appeal, ¶¶9, 10).

In light of Bankruptcy Rules 10-801 and 805, and the finality of judicial sales in general, this subsequent consummated sale to Doyle made this appeal from the earlier reversal of the order confirming the sale to Dominick's moot. Accordingly, Hancock moved for dismissal of the appeal on grounds of mootness, and was joined in that motion by AMF and the Trustees. On the return date, November 3, 1976, the motion was referred to the panel that is to hear this appeal. AMF respectfully refers the Court to its memorandum submitted at that time in support of the motion to dismiss.

ARGUMENT

THE DISTRICT COURT PROPERLY REVERSED THE ORDER CONFIRMING THE SALE TO DOMINICK'S BECAUSE THE BEST INTERESTS OF CREDITORS REQUIRED THAT THE DEFECTS IN NOTICE BE CURED BY A REOPENED SALE.

A. The Action of the District Court Properly Reflected the Best Interests of Creditors

Dominick's brief presents a wide assortment of esoteric arguments to support its attack on the decision of

Judge Cannella. The thrust of these arguments is that Hancock received all that he deserved from the Bankruptcy Court. Dominick's has avoided entirely the question of what creditors are entitled to and has thoroughly confused the relatively simple situation which was before Judge Cannella.

Judge Cannella decided an appeal from an order confirming a sale by trustees in Chapter X reorganization proceedings. The Bankruptcy Court did not comply with the requirements of Bankruptcy Rule 10-209(b) concerning notice of the sale. Moreover, although the notice did not disclose, and indeed was not intended to disclose (A. 525a), that public bidding would be accepted at the sale, in fact bids were accepted and the property was sold to the highest bidder. In light of the bid informally conveyed to the Bankruptcy Judge by Hancock on the same day as the hearing (A. 11a, 90a), it was clear that if the sale were reopened there would be a substantial benefit to creditors of at least $40,000, and likely more.

This Court declared which interests are to prevail on an appeal from an order of confirmation in In re General Insecticide Co., 403 F.2d 629 (2nd Cir. 1968). In that case the Bankruptcy Referee had confirmed a sale which took place without notice to the creditors at a price substantially below the appraised value. No appeal was taken

from the order of confirmation of that sale but approximately eight weeks later a creditor petitioned the referee to set the sale aside on grounds of inadequate price and notice and a potential conflict of interest. The Bankruptcy Referee denied the petition and was affirmed by the District Court, "noting that it was reviewing not an order of confirmation but an order denying a petition to set aside a sale." 403 F.2d at 630. This Court said that "If this court were now reviewing a confirmation, it would probably reverse the judgment below...." However, it was prevented from doing so because:

> "The standard for setting aside a sale is stricter than that applied in a direct attack upon a confirmation. In the latter, the governing principle is to obtain the best price for the bankruptcy estate whereas in the former there is greater emphasis upon finality in judicial sales and executed contracts, unless they are tinged with fraud, error or similar defects which would in equity affect the validity of any private transaction." 403 F.2d at 630-631.

See, to the same effect, 4A Collier's on Bankruptcy, ¶70.98, p. 1183 (14th Ed. 1976).

Here it was clear from the record before Judge Cannella, and in particular the obvious confusion of Hancock and his attorney at the May 17, 1976, hearing, that the actions of the Bankruptcy Judge had been determined by considerations of finality, and not the best interests of the creditors.

By contrast, the action of Judge Cannella was certain to procure at least an additional $40,000 for the Trustees. With notice specifying that bids would be accepted, and with wider distribution of the notice, it was likely that an even greater amount might be realized for the benefit of the creditors. In light of In re General Insecticide, supra, Judge Cannella's action was clearly correct.

As it turned out, the result of the reopened sale was a very substantial benefit to the debtor's estate and its creditors. The ultimate sale price was not just $40,000 greater than the price confirmed in the May 24, 1976 order, but almost double the earlier sale price or $1,210,000 (S.A. 589a). Indeed, the disparity between the price to Dominick's and the ultimate price to Doyle is such that a sale at the earlier price of only half the market value may well be said to "shock the conscience", In re Burr Mfg. & Supply Co., 217 F. 16 (2nd Cir. 1914), and considered with the other irregularities of that sale, would mandate setting aside the sale to Dominick's even if there had not been a timely appeal from the confirmation of that sale.*/

*/ The appraisal yielding a value of $650,000 (Dominick's Br., p. 7) was obviously grossly inadequate, in light of the market value of $1,210,000 realized at auction.

Dominick's has totally failed to comprehend the teaching of _In re General Insecticide_, _supra_. Thus it argues "once the sale is confirmed, '[t]he standard for setting aside a sale [becomes] stricter than that applied in' attempting to persuade the bankruptcy court to refuse confirmation of the sale. _In re General Insecticide_, _supra_, 403 F.2d at 630-631." (Br., p. 50). That is not what this Court held, as appears from the text on page 6 above. The whole point of _In re General Insecticide_, _supra_, is that the standard becomes "stricter" only if a sale is confirmed and no timely appeal has been taken therefrom, not, as Dominick's argues, when an order of confirmation is made by a Bankruptcy Judge. From its misreading of that case, Dominick's draws the erroneous conclusion in Point V of its brief that, on appeal to the District Court, Hancock and AMF were required to show that the sale to Dominick's was "tinged with fraud, error or similar defects" in order to set it aside, (Br., p. 52) because to do otherwise would undermine the finality of judicial sales. (Br., p. 58).

This proposition, exactly contrary to the holding of _In re General Insecticide_, _supra_, is reached by completely

ignoring the distinction made in that case. Once it is appreciated that there is a difference between an appeal from an order of confirmation, and a motion to set aside a previously confirmed sale, it becomes apparent that Point V of Dominick's Brief is directed almost entirely to the latter situation which is not presented by this appeal.

It is perhaps in an attempt to make relevant Point V of its brief that Dominick's insists that Judge Cannella reversed two orders of the Bankruptcy Court, not only the order of confirmation dated May 29, 1976, but also the order made from the Bench by Bankruptcy Judge Ryan on June 28, 1976, denying the motion of AMF and Hancock for an order setting aside the previously confirmed sale. (Br., pp. 5, 6, 18, 19). However, the fact is that the District Court took no action with respect to the order of June 28, 1976. No appeal was taken to the District Court from that order, and having reversed the order of confirmation, it was not necessary that the subsequent order be considered at all. Point V of Dominick's Brief is directed to a decision which was not made by Judge Cannella and is not before this Court.

Likewise, Point I (Hancock received lawful and adequate notice of the hearing) and Point II (Hancock waived any possible objection to the entertainment of other bids at the May 17 hearing) of the Dominick's Brief are largely irrelevant to the question before Judge Cannella. The thrust of these two points read together would seem to be that Hancock was not treated unfairly at the May 17, 1976 hearing. However, the balancing of interests required is not between those of Hancock and Dominick's, but between those of the creditors and the buyers. See In re General Insecticide, supra.

The notice to Hancock, whatever it may have been, cannot substitute for notice to creditors. If more adequate notice to Hancock would have benefitted the creditors, they should have that benefit. Whatever waiver Hancock's actions may have constituted as to himself, they cannot be a waiver of the rights of creditors which were protected by the taking of a timely appeal from the order of confirmation.

B. The Notice of the Sale was Defective.

The essential question on which the appeal was taken to the District Court by AMF and Hancock was whether or not proper notice had been given of the sale. (A. 141a, 143a). Judge Cannella correctly decided that there was not

adequate notice that offers would be accepted from prospective purchasers other than Hancock (A. 14a) and that the notice did not comply with the requirements of Bankruptcy Rule 10-209(b)(4), (A. 15a).

1. <u>The failure to give timely notice to creditors</u>.

Bankruptcy Rule 10-209 reads in pertinent part as follows:

> "Rule 10-209. Notices to Creditors, Stockholders, and United States
>
> * * * * *
>
> (b) Twenty-Day Notice to all Creditors and Parties in Interest. Except as provided in subdivision (f) of this rule, the trustee or debtor in possession shall give all creditors, stockholders, and indenture trustees, at least 20 days' notice by mail of ... (4) any proposed sale of property, other than in the ordinary course of business, including the time and place of any public sale, unless the court for cause shown shortens the time or orders a sale without notice ...."

This rule has yet to be considered by a reported decision. However, Bankruptcy Act §58(a)[*/] (11 U.S.C.A. §94(a)) which imposed similar requirements upon straight bankruptcy sales has been construed, and its directives are "mandatory"

[*/] "§58. Notices. a. Creditors shall have at least ten days' notice by mail, to their respective addresses as they appear in the list of creditors of the bankrupt or as afterward filed with the papers in the case by the creditors of ... (4) all proposed sales of property: Provided, that the court may, upon cause shown, shorten such time or order an immediate sale without notice."

unless "cause" is shown, In re Insulation & Acoustical Specialties Co., Inc., 426 F.2d 1189 (8th Cir. 1970). This being the case, "custom and practice by the Bankruptcy Referee of not giving notice cannot prevail over the requirements of statutory notice of "all proposed sales of property" to the list of creditors of the bankrupt. Id. See also Wolverton v. Shell Oil Company, 442 F.2d 666 (9th Cir. 1971).

It should be noted that both of these cases involved not a direct attack in an appeal from an order of confirmation but a subsequent motion to set aside a sale which was granted. In the instant situation where the District Court was considering an appeal from a confirmation, the required adherence to the statutory requirements should if possible be even stricter.

The notice that was given of the May 17, 1976 hearing admittedly did not satisfy the requirements of Bankruptcy Rule 10-209 as to those persons who are to receive notice of the sale or the number of days of notice actually given (Dominick's Br., pp. 35, 37).*/ The question

*/ 14 days notice was given to only those parties which had filed statements pursuant to Section 210 and 211 of the Bankruptcy Act, ("U.S.C.A. §§610, 611") and to Hancock. No other creditor, including AMF, or shareholder received notice.

before Judge Cannella was whether cause was shown for these deviations. The order to show cause bringing on the hearing of May 17, 1976, makes no mention of a finding or justification of the abbreviated notice. At the hearing on May 17, 1976, there was no finding of good cause or even mention of the abbreviated notice. Judge Cannella held that "the language of the Rule makes it clear that unless cause is shown such notice is required," and that there was no "finding by the Judge that such notice would be appropriate under the circumstances." (A. 15a).

Judge Cannella clearly had no choice other than to remand the matter to Judge Ryan for proceedings adhering to the requirements of the Bankruptcy Rules.

Dominick's contends in Point III of its brief (pp. 38-40) that the observations made by Bankruptcy Judge Ryan at the hearing on June 28, 1976, constitute adequate findings to meet the requirements of "cause shown". The argument that findings justifying abbreviated notice may be made after the notice was mailed, after the hearing at which abbreviated notice was given, after entry of the order confirming the sale made at the hearing of which abbreviated notice was given, and after the taking of an appeal from that order in which the failure to find good cause was designated as the basis for the appeal (A. 143a,141a) merely needs recital to fall of its own weight.

In re DCA Development Corporation, 489 F.2d 43 (1st Cir. 1973) does not approve the propriety of retroactive factfinding as claimed by Dominick's (Br. p. 39). That decision held that any deficiency in the extent of detail in the findings of fact made by the Referee pursuant to Fed.R.Civ.P. 52 (a) was corrected by the detailed findings made in the certificate prepared by the Referee on the appeal from his decision. Such an "expanded" certificate fully served the purpose of the requirement of detailed findings, to provide the appellate court with "a complete understanding" of the reasons behind the order. 489 F. 2d at 48. However, there is no suggestion in that case that the Referee heard evidence or conducted a hearing subsequent to the order appealed from. Here, no application for a finding of "cause shown" for deviation from the Bankruptcy Rules, nor any evidence in support of such a finding, whether by affidavit, testimony or otherwise, was made or offered before the Bankruptcy Judge until weeks after entry of the order appealed from. While in appropriate circumstances the court is certainly permitted to amplify findings made earlier in a subsequent more detailed report, e.g. In re DCA Development Corporation, supra, we know of no authority permitting it retroactively to correct its failure to hear evidence or make any findings at all.

2. <u>The failure to give notice of bidding</u>.

The notice of hearing admittedly also made no mention of the fact that public bidding would be accepted. (Dominick's Br., p. 11n). Judge Canella in essence found that whether or not Hancock had actual knowledge that another party would appear and bid, the notice used combined with the appearance of a bidder and acceptance of bids was such as to create an unacceptable level of confusion in the proceedings of the bankruptcy court. From the guidance available from the Bankruptcy Rules, and considering the regard required for the best interests of the creditors, Judge Canella was correct.

The only applicable rule on the subject is again Bankruptcy Rule 10-209(b) which specifies that in the case of a public sale the notice must include the time and place. It would seem implicit in that requirement that the notice indicate whether or not the sale is public. If this be the case, neither Bankruptcy Judge Ryan nor any other bankruptcy court may have the discretion to decide whether or not a notice shall state whether bidding is to be accepted.

From the point of view of the creditors, failure to state that bidding would be permitted was undoubtedly prejudicial. As Judge Cannella noted in his remarks at the hearing on June 28, 1976, any recipient of the notice

other than, arguably, Hancock or Dominick's would believe that the sale was a _fait accompli_ (A. 508(a)). Indeed, Dominick's found out that bidding would be accepted only by informal communication with the Trustees. While bidding is not required, _see_ Bankruptcy Rule 10-607(b), if it is to be permitted, it is obviously in the best interests of the creditors that the notice of such bidding be as wide as possible. Here, after the giving of notice that bids would be accepted, Doyle, who was not present at the first sale, appeared and the result of his bidding can only be described as a very substantial benefit to the debtor's estate.

We further suggest that, whatever the practice may be of giving notice of bidding in the Southern District of New York, in the case of a Chapter X reorganization involving assets throughout the country, understanding of notices promulgated by the court should not depend upon a knowledge of parochial custom.

Dominick's places much reliance on _Freehill v. Greenfeld_, 204 F. 2d 907 (2nd Cir. 1953) (Dominick's Br., p. 21) for its strenuous argument that Hancock must be charged with notice of public bidding. (Br., Pt. I). A review of the facts of that case indicate that Judge Hand would likely not have spoken so forcefully in the instant circumstances. There, the prospective purchaser was attempting to regain the deposit paid by him pursuant to his

contract with the Trustee on the ground that bidding had been permitted after the contract was made and that therefore the contract only constituted an offer and not a binding agreement. However, although bidding was permitted, no bids were placed and the contract buyer was clearly attempting to avoid his obligation on a meaningless technicality which had not prejudiced him in any way. Judge Hand held under the circumstances that the provision of the contract making the sale subject to the approval of the court charged the buyer with knowledge that approval of the court might be conditioned upon the absence of higher bids. Here, Hancock is not asserting lack of notice of bidding as a means to avoid his obligation, but to show that had he been properly informed the estate would have been further enriched. In any event, it is most unlikely that Judge Hand would have held that the notice of May 3, 1976, would have given notice to parties other than Hancock that bidding was a possibility, as it contained none of the terms of the contract.

3. The Bankruptcy Court made none of the findings required by the Bankruptcy Rules for abbreviated notice.

In Point IV of its argument, Dominick's would hope to avoid altogether a consideration of the merits

of Bankruptcy Judge Ryan's order of confirmation of May 24, 1976, by arguing that the "clearly erroneous standard" prohibits the District Court from substituting its findings for those of the Bankruptcy Judge (Br., pp. 41-48). All of the findings of the Bankruptcy Judge which it is argued did not receive sufficient deference from Judge Cannella were made at a hearing held June 28, 1976, (Br., p. 41) five weeks after entry of the order appealed to Judge Cannella by AMF and Hancock. Although the June 28th order was not considered by Judge Cannella,*/ Dominick's insists that Judge Cannella reversed two orders of Bankruptcy Judge Ryan (Br., pp. 1, 6, 11, 18, 19) made on May 24, 1976, and June 28, 1976. The purpose this insistance serves in the argument of Dominick's becomes clear in Point IV of its brief.

No appeal from the reversal of the May 24, 1976, order could possible lie on grounds of violation of the "clearly erroneous" standard, as Judge Cannella found only that the Bankruptcy Judge had totally failed to make any finding of fact as to the appropriateness of the notice given to creditors and to Hancock prior to or at the time of confirmation of the sale to Dominick's. This was ob-

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*/ See p. 9, supra.

viously the case, and even Dominick's is unable to point out to this Court a single finding of fact made by the Bankruptcy Court prior to the filing of the appeal to Judge Cannella which is at variance with his decision.

Dominick's endeavors to cross this gap in the record by comparing Judge Cannella's decision with the record made by Bankruptcy Judge Ryan on June 28, 1976, in denying a motion that was never appealed to, and the merits of which were not considered by Judge Cannella. Having raised the false issue of the order of June 28, 1976, Dominick's attempts to stand in it with the argument that Judge Cannella committed reversible error by disregarding the findings of fact made by the Bankruptcy Court in violation of the "clearly erroneous" standard. This bootstrap argument is so transparent it needs no further discussion here.

C. Summary of Argument

In the course of its lenghty brief, Dominick's has sought to impeach the correctness of Judge Cannella's decision on numerous peripheral and immaterial issues. It has urged upon this Court a totally confused view of the standard by which Judge Cannella was to review the order of confirmation (Point V), argued violation by Judge Cannella of the "clearly erroneous" standard based on an incorrect and self-serving view of the record (Points III and IV) and vigorously argued that Hancock can claim no prejudice from

the manner in which the sale to Dominick's was conducted (Points I and II). Nowhere does Dominick's address the central issue present by this appeal: Was the decision of Judge Cannella in the best interest of creditors, as mandated by In re General Insecticide, supra? When his decision is squarely addressed, the answer must be "yes". The District Court reversed the order of confirmation of May 24, 1976, because there was a clear failure to comply with the Bankruptcy Rules and unnecessary confusion was created by the manner in which the sale was noticed and conducted. Both of these irregularities may have prejudiced the interests of creditors. It was clear at that time that a reopened sale would bring a substantial benefit to the creditors, and subsequent events have amply confirmed this, with the price realized for the property almost doubled.

The only way that Dominick's can argue that the decision was incorrect is to totally ignore the interests of creditors, and that it has done to a fair-thee-well. This Court however, has clearly stated that those interests are paramount in this appeal. Because the decision of Judge Cannella was entirely consistent with those interests, it should be confirmed.

CONCLUSION

This Court is urged in the accompanying motion to dismiss this appeal on grounds of mootness. AMF vigorously supports this motion, as the events subsequent to the order appealed to this Court have indeed rendered the merits of this appeal moot. Should the Court decline to grant that motion, then for the reasons stated above it should affirm the decision of the District Court.

Respectfully submitted,

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